BEFORE THE
ILLINOIS COMMERCE COMMISSION

ILLINOIS BELL TELEPHONE COMPANY	)	
Proposed increase in wholesale rates.	)	Docket No. 02-0864
	)	

REBUTTAL TESTIMONY

OF

WILLIAM DUNKEL

ON BEHALF OF

THE PEOPLE OF THE STATE OF ILLINOIS,
By the ILLINOIS ATTORNEY GENERAL'S OFFICE

January 20, 2004

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I. INTRODUCTION AND PURPOSE OF TESTIMONY

Q. ARE YOU THE SAME WILLIAM DUNKEL WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING ON BEHALF OF THE ILLINOIS ATTORNEY GENERAL'S OFFICE?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of this testimony is to respond to the Direct Testimonies filed by intervenors in this proceeding.

II. FILL FACTORS

Q. ON PAGE 36 OF YOUR DIRECT TESTIMONY, YOU RECOMMEND THAT THE FILL FACTORS THE COMMISSION ADOPTED IN THE PRIOR SBC ILLINOIS (SBCI) UNE PROCEEDING BE USED IN SBCI'S UNE-L LOOP COST MODEL. DID ANY OTHER PARTY MAKE THIS SAME RECOMMENDATION?

A. Yes. The Staff did. On page 18 of his Direct Testimony, Staff witness Green states:

> SBC Illinois has not shown why the fill factors authorized by the Commission in SBCI's last UNE rate case are now inappropriate. Therefore, I recommend that the Commission reject SBCI's proposed fill factors and adopt my recommendation to use the fill factors the Commission adopted for SBCI in Docket No. 96-0486/96-0569.

Q. BEGINNING ON PAGE 6, LINE 109 OF HIS DIRECT TESTIMONY, STAFF WITNESS GREEN STATES THAT SBCI'S CURRENT EMBEDDED FILL RATES

DO NOT REFLECT THE MOST EFFICIENT FORWARD-LOOKING FILL RATES.

DO YOU AGREE?

A. Yes. Mr. Green makes the following statements in his Direct Testimony:

> [A]n embedded network that may have been efficient when designed may no longer be an efficient network today and no longer forward-looking.[1]

He also testifies that:

> The company has been provisioning cables for decades and many of these older cables are still in use today. There are cables that were previously used to serve factories, businesses, and residential areas that are much smaller or no longer exist and, as a result, produce much less demand upon the network than before. The current embedded fill on these cables is, therefore, disproportionately low.[2]

He also states:

> The current embedded network from which the current fills have been determined is a network that has evolved over decades.[3]

Mr. Green makes a number of important points. If SBCI's embedded network contains pairs of distribution cables that were once used to serve people or businesses that have since abandoned that area, those unneeded pairs of distribution cable would be included in SBCI's embedded fill rates. For example, if, decades ago, SBCI installed distribution pairs to serve an area filled with hotels or large office buildings, that have since been demolished or are vacant, the unused distribution pairs would be included in SBC's embedded fill rates. A forward-looking, efficient model of distribution facilities would not assume the installation of many distribution pairs to serve a deserted area. Changes in demand that have occurred over many, many years can cause embedded fill rates to be less than the most efficient level of fill.

[1] Staff Ex. 10.0 at 12, lines 224-226.
[2] Staff Ex. 10.0 at 12, lines 233-237.

It would be unfair for CLECs to be forced to pay for embedded distribution spare pairs that are there only because there used to be a large demand in that area.

As I pointed out on page 35 of my Direct Testimony, SBCI's distribution fill factor would require CLECs to pay for ** ** distribution pairs for every pair (i.e. UNE loop) the CLEC buys from SBCI. If a CLEC purchased two UNE loops to a single house from SBCI, the CLEC would be required to pay for ** ** distribution pairs. If the CLEC wanted to use an additional line, it would be forced to pay for an additional ** ** lines instead of using one of the spares the CLEC was already required to pay for. This is clearly not efficient. Some level of spare capacity is necessary (e.g. to account for bad or defective pairs, to allow for future growth, etc.). However, CLECs should only be required to pay for a reasonable and efficient level of spare capacity.

III. DEPRECIATION LIVES

Q. ON PAGE 41 OF YOUR DIRECT TESTIMONY, YOU CONCLUDED THAT SBCI HAS NOT DEMONSTRATED THAT THE DEPRECIATION LIVES ESTABLISHED BY THE ICC IN SBCI'S PRIOR UNE PROCEEDING ARE UNREASONABLE. YOU THEN RECOMMEND THAT THE ICC'S PREVIOUSLY ADOPTED LIVES CONTINUE TO BE USED IN THE UNE COST MODELS. DO OTHER PARTIES HAVE SIMILAR PROPOSALS?

A. Yes. The Staff has the same proposal. On page 13 of his Direct Testimony, Staff witness Wagner states:

[3] Staff Ex. 10.0 at 8, lines 139-141.

> In summary, SBCI has not adequately demonstrated that its proposal to decrease its equipments' lives is appropriate, justified, or realistic.
>
> SBC Illinois' proposal to drastically reduce lives for equipment in its telephone network should be rejected by the Commission. My recommendation is that the Commission re-affirm the equipment lives it prescribed for SBC in Docket 96-0486/0569.

In addition, Mr. Majoros, a witness for AT&T and WorldCom, makes the same proposal:

> I conclude, therefore, that the depreciation parameters currently prescribed by the FCC for SBC Illinois should be used in determining the prices for unbundled network elements ("UNEs").[4]

He goes on to state that the ICC adopted the FCC depreciation parameters in the prior SBC UNE case.[5] His recommendation is:

> The Commission should not find it necessary to depart from the FCC lives it adopted in 1998.[6]

Q. ON PAGE 36 OF HER DIRECT TESTIMONY, CUB WITNESS BALDWIN DISCUSSES DR. VANSTON'S FORECAST OF MASSIVE COPPER RETIREMENTS TO BE REPLACED BY FIBER IN THE DISTRIBUTION PORTION OF THE LOOP IN THE NEAR FUTURE. MS. BALDWIN STATES THAT DR. VANSTON'S PREDICTION IS "SO SPECULATIVE AS TO BE IRRELEVANT." DO YOU AGREE WITH MS. BALDWIN'S ASSESSMENT OF DR. VANSTON'S PROJECTION?

A. Yes. As I demonstrated in my Direct Testimony, Dr. Vanston has been making similar predictions of massive copper distribution loop retirements for many years, and his

[4] ATT / MCI Joint Ex. 1 at 4.
[5] ATT / MCI Joint Ex. 1 at 4.
[6] ATT / MCI Joint Ex. 1 at 15.

predictions have proven to be totally unreliable. For this proceeding, I reviewed Dr. Vanston's study and forecasts that he performed in 1994, in order to see how his predictions have panned out. Back in 1994, Dr. Vanston's study forecast that by the year 2003, 42% of the loops would be served by fiber distribution cable instead of copper distribution cable. Of course that did not happen. Dr. Vanston's revised 2002 forecast, offered as pre-filed evidence in this proceeding,[7] indicates that only 1% of distribution lines will be fiber in 2003, but predicts that 50% will be fiber in the year 2011.[8] I have no reason to believe Dr. Vanston's forecast in his 2002 study is more accurate or reliable than his forecast was in 1994, and it should be disregarded.

Q. MS. BALDWIN RECOMMENDS LOOKING TO THE FCC FOR GUIDANCE REGARDING THE PROPER DEPRECIATION LIVES TO BE USED IN TELRIC COST STUDIES. HASN'T THE FCC SPECIFICALLY REJECTED DR. VANSTON'S FORECAST OF MASSIVE COPPER RETIREMENTS AND FIBER REPLACEMENTS?

A. Yes. As I discussed on page 38 of my Direct Testimony, the FCC has rejected Dr. Vanston's forecasts. The FCC specifically concluded "There is no evidence that the large wave of plant replacements forecast by TFI, which should result in increased retirements, has begun or is about to begin." As I demonstrated in my Direct Testimony, the SBCI data is consistent with that FCC conclusion.[9]

[7] SBCI Ex. 13.0.
[8] Direct Testimony of William Dunkel on behalf of the Peoples of the State of Illinois at 39.
Direct Testimony of William Dunkel on behalf of the Peoples of the State of Illinois at 40, and at Schedule WDA-17.

IV. REMOTE TERMINAL ENGINEERING AND INSTALLATION COSTS

Q. ON PAGES 28-30 OF YOUR DIRECT TESTIMONY, YOU DEMONSTRATED THAT SBCI'S UNE LOOP COST STUDY GREATLY OVERSTATES THE INSTALLATION COSTS (INCLUDING THE ENGINEERING COSTS) OF REMOTE TERMINALS. DID THE STAFF TAKE ISSUE WITH THESE COSTS AS WELL?

A. Yes. Beginning on page 23 of his Direct Testimony, Staff witness Lazare states that SBCI's proposed remote terminal installation costs are greatly in excess of the installation cost data SBCI provided in response to discovery in this proceeding. There are two different sizes of remote terminals in the SBCI cost study (i.e. the model LSC-2016 and the LSC-672). Mr. Lazare proposes an installation cost of ** ** for either size of remote terminal.[10] For the LSC-2016 model, Mr. Lazare's proposed installation costs are ** ** less than the costs proposed by SBCI. For the LSC-672 model, Mr. Lazare's proposed installation costs are ** ** lower than SBCI's proposed installation costs.[11] Although Mr. Lazare's proposed installation costs are higher than I had proposed[12], in an effort to minimize areas of dispute, I do not oppose Staff's proposed remote terminal installation and engineering costs. The Staff's proposed costs are much more reasonable than those proposed by SBCI.

V. UNCOLLECTIBLE EXPENSE

[10] Staff Ex. 3.0 at Schedule 3.
[11] Staff Ex. 3.0 at pages 22-23.

Q. ON PAGE 42 OF YOUR DIRECT TESTIMONY, YOU INDICATED THAT THE UNCOLLECTIBLE EXPENSE FACTOR SBCI USED IN ITS CALCULATION OF SHARED AND COMMON COSTS IS UNREASONABLY HIGH. DOES THE STAFF PROPOSE A MUCH MORE REASONABLE UNCOLLECTIBLE FACTOR?

A. Yes. As I pointed out on page 43, line 1 of my Direct Testimony, SBCI is proposing an uncollectible factor of ** ** in its UNE cost study in this proceeding. As I pointed out on page 43 of my Direct Testimony, SBCI's actual uncollectible rate for wholesale services was less than ** **. On Schedule 8 attached to the Direct Testimony of Staff witness Qin Liu, the "Staff's Uncollectible Factor" is shown to be ** **, which was used to develop the Staff's proposed UNE rates. This factor is very close to the actual uncollectible rate for wholesale services. Therefore, the Staff's proposed uncollectible factor is much more reflective of the actual uncollectible rate for wholesale services that SBCI incurs, than is the greatly inflated factor proposed by SBCI.

VI. INCREASE IN THE SBCI BUSINESS BASIC RETAIL RATE

Q. ON PAGE 12 OF YOUR DIRECT TESTIMONY, YOU INDICATED THAT DUE TO IMPUTATION REQUIRMENTS, SBCI'S PROPOSED INCREASE IN THE UNE LOOP RATES WOULD MOST LIKELY REQUIRE SBCI BASIC RETAIL RATE INCREASES FOR BUSINESS CUSTOMERS. DID THE STAFF MAKE THIS SAME OBSERVATION IN ITS DIRECT TESTIMONY?

A. Yes. Staff witness Koch states:

[12] Direct Testimony of William Dunkel on behalf of the Peoples of the State of Illinois at 28, lines 13-15.

> SBC's proposal would, for its rates to pass imputation, require an increase in retail business access line rates of over $200 million annually.[13]

Q. DID OTHER PARTIES POINT OUT THAT UNE RATE INCREASES COULD LEAD TO INCREASES IN END-USER RETAIL RATES?

A. Yes. On page 6 of her Direct Testimony, Citizens Utility Board (CUB) witness Baldwin states:

> Although consumers do not purchase UNE loops, the huge rate increase that SBC proposes, if adopted, would affect consumers in the prices they pay to SBC's competitors for local telecommunications services. Also, because business services have been classified as competitive, they must pass an imputation test, thus creating pressure on business retail rates.

VII. OTHER CORRECTIONS NOT ACCOUNTED FOR IN STAFF'S PROPOSED UNE LOOP RATES

Q. YOU HAVE DISCUSSED A NUMBER OF CORRECTIONS TO SBCI'S UNE LOOP COST STUDY THAT HAVE BEEN ADDRESSED IN STAFF'S PROPOSED UNE LOOP COSTS AND RATES. ARE THERE OTHER CORRECTIONS THAT SHOULD BE MADE?

A. Yes. Although the Staff made a number of corrections to the SBCI cost study, they did not correct at least two SBCI errors.[14] As a result, these two SBCI errors continue to impact the results the Staff has presented and should be added to the corrections the Staff has presented. These two errors are:

1. Double counting NID and Drop costs, and

[13] Staff Ex. 4.0 at 37, lines 780-782.
[14] This statement does not imply that no other corrections should be considered.

2. Including Building costs in Remote Terminal costs for Remote Terminals that are not in a building.

I will discuss each of these problems in more detail below.

Q. HAVE YOU RE-CALCULATED THE STAFF'S PROPOSED UNE LOOP COSTS TO INCORPORATE THESE TWO ADDITIONAL CORRECTIONS?

A. Yes. I started with the Staff's proposed UNE loop cost study, and revised those costs to incorporate these two additional corrections. The results of my revised costs are shown on Schedule WDA-R1, for the 2 wire, zone 3, analog UNE loop.

For comparison, Schedule WDA-R2 is the summary page from the Staff cost study showing Staff's proposed costs, before making these two corrections, for the same UNE loop (i.e. 2 wire, zone 3, analog UNE loop).

Q. PLEASE DISCUSS THE FIRST CORRECTION YOU MADE.

A. As I discussed in my Direct Testimony, SBCI's UNE loop cost study double counts the costs of the NID and Drop.[15] The problem with the SBCI cost study is that it includes the same costs in <u>two different places</u> in the cost study. Specifically, SBCI includes the NID and Drop costs in the "Premises Termination" costs, and also includes them in the "Installation Factors" as loadings included in the copper distribution and feeder cable costs. This error is described in more detail on pages 18-25 of my Direct Testimony.

[15] Direct Testimony of William Dunkel on behalf of the Peoples of the State of Illinois at 18-25.

This is a significant issue. For example, double recovering these NID and Drop costs improperly adds more than ** ** per line to the 2 wire, zone 3, analog monthly cost.

Q. CAN YOU ILLUSTRATE HOW THESE COSTS ARE DOUBLE RECOVERED IN THE METHOD USED IN THE SBCI STUDY AND CARRIED THROUGH INTO THE STAFF STUDY?

A. Yes. Assume a hypothetical company has the following costs:

	Materials:	Installation Labor:
NID and Drop:	$750,000	$1,500,000
Distribution Cable:	$1,000,000	$2,000,000

The proper cost study of that company would be as follows:

Premises Termination:	Materials		Labor		Total
NID and Drop:	$750,000	+	$1,500,000	=	$2,250,000
Distribution:					
Cable:	$1,000,000	+	$2,000,000	=	$3,000,000
Grand Total:[16]					$5,250,000

Q. USING THE METHOD USED BY SBCI (AND CARRIED THROUGH INTO THE STAFF STUDY) WHAT COST WOULD RESULT FROM THE ABOVE DATA?

A. The method used by SBCI (which is carried through into the Staff study) would produce an incorrect total cost of $7,500,000 for the above company, as follows:

[16] This hypothetical assumes no other costs, for simplicity.

I. The Cost Study Using SBCI Method:

Premises Termination:

	Materials		Labor		Total
NID and Drop:	$750,000	+	$1,500,000	=	$2,250,000

Distribution:

Cable Material:	$1,000,000
0.75 Sundry and Misc. Loading Factor (see below)	
Cable Material Cost of $1,000,000 =	+ $750,000
(This adds the NID and Drop material cost)	
3.5 Telco Labor Loading Factor (see below)	
Cable Material Cost of $1,000,000 =	+$3,500,000
(Adds the labor to install NID, Drop and Cable)	
Total Distribution Cost:	$5,250,000
Grand Total Cost:[17]	**$7,500,000**

II. Calculation of Loading Factors Used Above:

1. Sundry and Misc. Loading Factor:

NID and Drop Material Cost ("Exempt" Matl.):	$750,000/	
Cable Material Cost:	$1,000,000	= 0.75 Misc. Loading Factor

2. Telco Labor Loading Factor:

NID and Drop Installation Labor:	$1,500,000
Cable Installation Labor:	+$2,000,000
Total NID, Drop and Cable Installation Labor:	$3,500,000

Labor Loading Factor:		
Total NID, Drop and Cable Labor (above):	$3,500,000/	
Cable Material Cost:	$1,000,000	= 3.5 Labor Loading Factor

The reason that the SBCI method overstates the cost is that the NID and Drop material and installation labor are included twice**.** They are included once in the Premises Termination costs, and included a second time in the Loading Factors, which add cost to the Distribution Cable.[18]

Q. DOES A SIMILAR DOUBLE COUNTING OF THE NID AND DROP COSTS EXIST IN THE STAFF STUDY?

A. Yes. It is important to note that the Staff did not create this problem. This double recovery originated in the SBCI study. Staff took the SBCI study and made some corrections, but none of these corrections eliminated the double recovery of the NID and Drop costs. Schedule WDA-R 4 tracks this double recovery of the NID and Drop costs through the Staff study, using the actual numbers from the Staff study and the actual printouts from the Staff workpapers.

The above discussion addresses material and labor. In a similar manner, the actual double recovery also includes double recovery of the Engineering costs and Vendor costs of the NID and Drop.

Q. WHAT IS THE SECOND ADDITIONAL CORRECTION THAT SHOULD BE MADE?

A**.** The second correction that should be made is to eliminate building costs improperly included in SBCI's UNE loop cost study for locations where there are no buildings.[19]

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[17] This hypothetical assumes no other costs, for simplicity.
[18] To be clear, I am not objecting to the concept of using Loading Factors in a cost study. I am objecting to double counting costs.
[19] Direct Testimony of William Dunkel on behalf of the Peoples of the State of Illinois at 26-28.

Specifically, as I pointed out on pages 26-28 of my Direct Testimony, SBCI's cost study assumes that SBCI will incur the cost of putting remote terminals inside buildings. In reality, these remote terminals are not placed inside buildings. These remote terminals are actually installed outside, without a building around them, because they have their own cabinets that serve as protection and shelter for the electronics inside the cabinets. The error occurs in the SBCI model when SBCI applies a "building" loading factor to the remote terminal investment. In my proposed correction, I adjust the cost study so that the "building" loading factor is not applied to the remote terminal investment.[20] This is a fairly small adjustment. For example, for the 2 wire, zone 3 analog loop, the difference in cost is approximately ** ** per line when the building factor is removed. This difference can be seen by comparing the monthly cost on the “Building” line on the Staff study (Rebuttal Schedule WDA-R2) ** **, and the monthly cost on the "Building" line on the Staff study with the two AG corrections (Rebuttal Schedule WDA-R1) ** **

[20] SBCI had also included the Remote Terminal investment in the denominator when calculating the “buildings” loading factor. To be consistent, I also recalculated the “buildings” factor without the Remote Terminal investment in the denominator, and used that corrected “buildings” factor.

Q. FOR REFERENCE, CAN YOU PLEASE PROVIDE A COMPARISON OF SBCI'S, STAFF'S, AND AT&T'S PROPOSED UNE LOOP RATES, TO THE RATES THAT RESULT FROM THE STAFF MODEL WITH THE TWO ADDITIONAL CORRECTIONS YOU HAVE JUST DISCUSSED?

A. Yes. A comparison of proposed rates for the 2 wire analog UNE loop is shown below:

	CURRENT[21]	SBCI[22]	STAFF[23]	STAFF, WITH 2 CORR.	AT&T[24]
Area A (Zone 1)	$2.59	$11.62	$4.23	** **	$1.24
Area B (Zone 2)	$7.07	$23.23	$7.88	** **	$2.94
Area C (Zone 3)	$11.40	$26.85	$9.39	** **	$4.56
Average	$9.81[25]	** [26]	[27]	[28]	[29]**

Q. HAVE YOU RE-CALCULATED ALL OF THE STAFF'S PROPOSED UNE LOOP COSTS AND RATES TO INCORPORATE THE TWO ADDITIONAL CORRECTIONS YOU HAVE DISCUSSED?

A. Yes. I started with the Staff's proposed UNE loop cost study, and revised those costs to incorporate these two additional corrections. I also calculated the resulting revised rates,

[21] Staff Ex. 5.0 at Schedule 8.
[22] SBCI Ex. 13.0 at 14, lines 317-319.
[23] Staff Ex. 5.0 at Schedule 8, public version.
[24] AT&T Ex. 2.0 at 167.
[25] Direct Testimony of William Dunkel on behalf of the Peoples of the State of Illinois at 7, line 15.
[26] Direct Testimony of William Dunkel on behalf of the Peoples of the State of Illinois at 7, line 16.
[27] In order to calculate the weighted average, I used SBCI's access lines in service by access area, which SBCI provided in response to AT&T Data Request JG 15.21. The data provided in that response indicates that ** ** of SBCI's lines are in Access Area A, ** ** are in Area B and ** ** are in Area C.
[28] In order to calculate the weighted average, I used SBCI's access lines in service by access area. See supra note 30 for details.
[29] In order to calculate the weighted average, I used SBCI's access lines in service by access area. See supra at note 30 for details.

using the same Shared and Common Factor and Uncollectible Factor the Staff used. The results of my revisions to Staff's proposed costs and rates are shown in Columns 5 and 6 on Schedule WDA-R3. In addition, Schedule WDA-R3 displays the currently effective UNE rates, the TELRIC and UNE rates proposed by Staff and SBC, and shows the UNE rates proposed by AT&T.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.